

WHAT TO CONSIDER WHEN DEVELOPING A LEASE AND A RENTAL RATE?

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Leasing Webinar Series
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COLLEGE OF
AGRICULTURE & NATURAL RESOURCES

DEPARTMENT OF AGRICULTURAL &
RESOURCE ECONOMICS

Disclaimer

This presentation is intended to provide general information about leasing laws and should not be construed as providing legal advice. It should not be cited or relied upon as legal authority. State laws vary and no attempt is made to discuss laws of states other than Maryland. For advice about how these issues might apply to your individual situation, consult an attorney.

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Agriculture Law Education Initiative

The Agriculture Law Education Initiative is a collaboration between the University of Maryland Francis King Carey School and College of Agriculture & Natural Resources, University of Maryland, College Park. Through the University of Maryland Extension - the statewide, non-formal agriculture education system - the collaboration partners with the School of Agricultural and Natural Sciences, University of Maryland Eastern Shore.

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- <http://www.mpowermaryland.com>

OVERVIEW

Overview



- Many of you, may want to lease farmland
 - Either as a landlord or a tenant
- Leasing can be a big deal
 - Want to make sure your goals match the other party's goals

Overview

- Things you will need to consider when leasing your property:
 - What are your priorities?
 - Get the lease in writing
 - Conservation practices
 - Is there water
 - Rent
 - More we will discuss

EVALUATE YOUR PRIORITIES

Evaluate Priorities

- What are your priorities?
 - Certain ways you want crops grown?
 - Long term lease?
- Why do you want to lease this land?
- Is the property zoned properly?
- Would an alternative relationship work better?
 - Custom farming?



Evaluate Priorities



- On special note: if you have a conservation easement on the property
- Make sure your priorities conform to the easement.

RANDOM OUT-OF-STATE PRODUCER

“I happen to disagree and feel that if there were more deals done with a handshake, this country would be a whole lot better off.”

Written Lease

- Quote highlights the problem in ag:
 - Lack of written farmland leases
 - Issues will exist with memory
- Developing a lease is not a simple document



Written Lease



- Will want to put lease in writing
- View it as a reference tool
- You can skip this of course if you and the other party both suffer from Hyperthymesia

CONSERVATION PRACTICES

Conservation Practices

- Important to remember is an implied covenant to use good husbandry practices in many leases
- Broad but means those agricultural practices that conserve fertility, usefulness, and value of the soil.
- May not fit your idea of conservation practices



Conservation Practices



- Clearly define what practices you want the farmer to use:
 - No-till
 - Organic
 - Rotational grazing
- You would be shocked how many landowners do not do this

Conservation Practices

- Along with conservation, make sure you understand environmental regs that will impact the farm
- Understand nutrient management regs



OTHER CONSIDERATIONS

Water, Water, Water

- Is there a source of water?
- Irrigation equipment?
- Who pays for repairs to any well?



Rent



- What is the rental rate going to be?
 - Cash rent
 - Crop-share
 - Flex-cash
- Will you reevaluate rent each year?
 - Will a 2013 rent work in 2015/16?

Rent

- Set a date rental payment is due on
- Make sure date is far enough from harvest to allow tenant to get records together. Big deal for crop-share and flex-cash



SOURCES



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Other Considerations

- Who is responsible for buildings, fences, or other structures on the farm?
 - Potential tradeoff in rent for tenant taking care of?
- Liability insurance
 - Is tenant going to be bringing people on the farm?
 - Should you require tenant to carry certain level of insurance
 - Landowner's homeowner's policy will typically not cover commercial activities from leasing a farm
- Crop Insurance
 - Cash lease – landlord may require
 - Crop-share – landlord may participate in

Other Considerations



- Developing issue, modern ag practices creates data:
 - Yield data from harvest
 - Nutrient data
 - Etc
- Clarify in the lease that you get access to this data when lease is terminated

Growing Crops

- What if you have crops growing when the lease terminates?
 - Common law view was if the lease had a definite termination date then not entitled to harvest growing crops
- Are exceptions to this rule
 - What is the practice in the area? Did landlord make some assurances?



Growing Crops



- Highlight this so you will remember to settle this issue in the lease.
- Typically way to handle is to allow tenant reasonable time to collect unharvested crops at harvest time

Legal Protections

- Get curious about discussion of growing crops and other legal protections
- Check out MD RME Blog at www.aglaw.umd.edu



How to compensate for improvements if the lease ends early?

- What happens if you decide a rented farm needs to be irrigated and your landlord doesn't agree, so you go out pay to put in the irrigation equipment and 3 years later landlord terminates the lease?
- Another way is to consider in the lease including language that before the tenant makes any improvements over a certain dollar value (for example \$500) will talk with landlord first:
 - Have landlord agree that improvement is necessary
 - If landlord won't pay set up payment schedule if lease terminated early.

How to compensate for improvements if the lease ends early?

- For example:
 - Tenant needs to include a barn on the rented farmland to aid with her cattle operation, barn would cost \$100,000 to build, have a useful life of 20 years, and depreciate at \$5,000/year.
 - Landlord agrees for the barn to be built and if the lease is terminated within the next 20 years, then landlord agrees to pay to tenant the undepreciated amount of the barn.
 - If terminated 1 year after building the barn then landlord would pay \$95,000 to tenant
 - If terminated in year 15, then landlord would pay tenant \$25,000.

Know How the Lease Terminates, Automatically Renews, and How to Recalculate Rent

- Want to know clearly early on how to terminate the lease or what if anything needs to be done to renew the lease.
- As tenant:
 - How many months notice would you like to get/give to terminate?
 - Should you be required to give notice that you want to renew the lease?
 - Should the rent be recalculated every few years?
- As landlord:
 - How many months notice is enough when terminating the lease? How long would it take to find a new tenant?
 - Do you want some kind of notice each year from tenant on renewing the lease?
 - How often should rent be recalculated?

Lease Termination

- Lease may terminate on certain date, may or may not require notice to be given
- Either party will need to follow proper termination process
- If lease specifies process, then follow that process exactly
- If lease doesn't then must follow Maryland law and that requires 6 months notice to terminate a farm lease (MD. Code Real Property Section 8-402)
 - Allows for oral notice of termination, but again better practice to use written notice.
 - Written provides a record.

Lease Renewal

- Lease renewal is always the responsibility of the tenant
 - Landlord can never force a tenant to renew
 - Landlord can only accept offer to renew or find a new tenant
- Lease can also extend automatically until notice of termination is given. Very common in agricultural leases.
- Maybe in both parties best interest to require some form of notice (around same time notice of termination would be due) that tenant would like to renew the lease the next year.

Resources Available for Landowners

- Cox, E. *Landowner's Guide to Sustainable Farm Leasing*, Drake Ag Law Center (<http://sustainablefarmlease.org/wp-content/uploads/2010/08/The-Guide2.pdf>).
- University of Maryland Extension's Leasing page at <http://bit.ly/MdAgLease>
 - *Agricultural Leasing in MD* guide
 - Cash rental rates
 - Form leases

SETTING A FAIR RENTAL RATE



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Question that I hate

- I hate the phone call that eventually ends with “Paul, is \$X a good rental rate?”
- Why do I hate this question?
 - Answer is simple, I have no idea what a good rental rate is on any property
 - Well I do but its going to be one that I’m actually farming on because I will know the issues we are about to discuss
- Thing is most of you will know what we are about to talk about

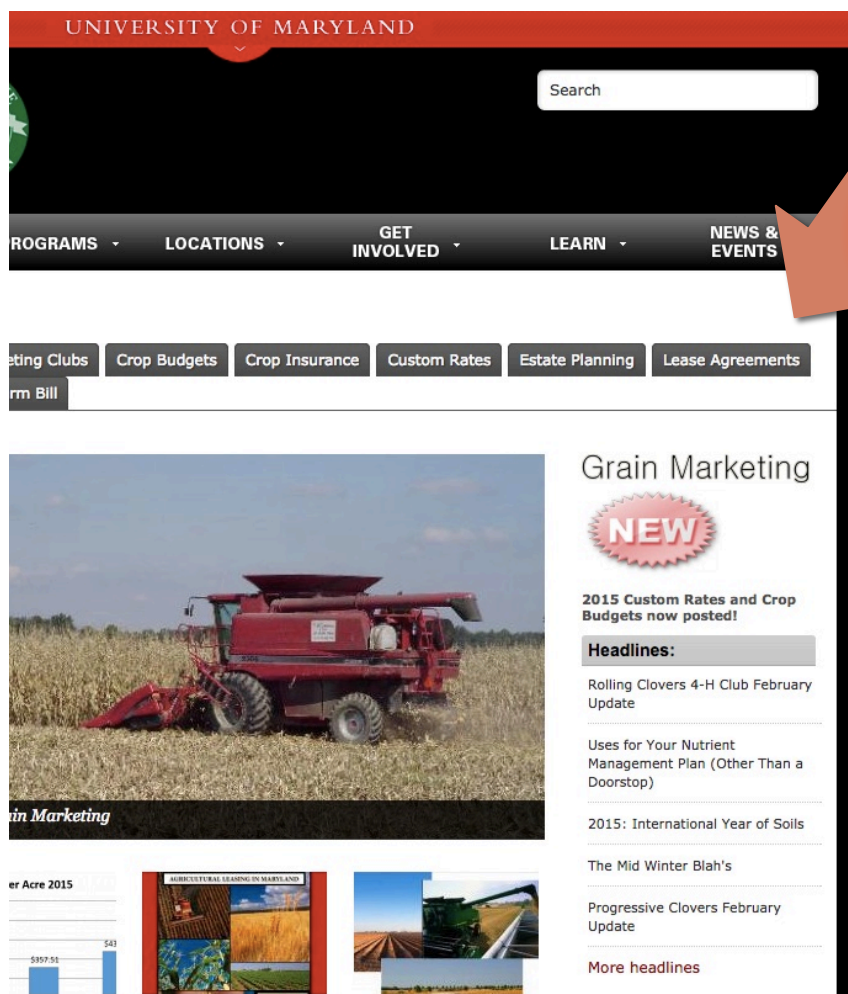
SIMPLEST WAY

Fair Rental Rate?

RENT, CASH, CROPLAND, NON-IRRIGATED - EXPENSE, MEASURED IN \$ / ACRE													
County	2002*	2003*	2004*	2005*	2006*	2007*	2008	2009	2010	2011	2012	2013	2014
Dorchester	\$67.50	\$62.72	\$73.58	\$82.56	\$76.92	\$77.54	\$65.50	\$76.00	\$68.50	\$75.50	\$66.00	\$83.00	\$ 95.50
Somerset	\$66.85	\$61.46	\$67.09	\$62.57	\$63.55	\$64.68	\$64.00	\$63.50	\$70.00	\$69.50	\$73.00	\$74.00	\$ 76.50
Talbot	\$69.77	\$78.40	\$74.86	\$76.71	\$83.12	\$83.02	\$71.00	\$78.00	\$75.50	\$77.50	\$105.00	\$114.00	\$ 109.00
Wicomico	\$53.91	\$58.56	\$62.86	\$71.45	\$73.20	\$73.21	\$64.00	\$65.50	\$64.50	\$67.50	\$84.50	\$80.50	\$ 77.50
Worcester	\$65.84	\$73.08	\$73.16	\$75.04	\$80.64	\$82.38	\$79.00	\$82.50	\$77.50	\$77.00	\$82.00	\$92.50	\$ 84.50

RENT, CASH, CROPLAND, IRRIGATED - EXPENSE, MEASURED IN \$ / ACRE					
State & County	2010	2011	2012	2013	2014
Dorchester	\$110.00	\$100.00	\$152.00	\$160.00	\$161.00
Somerset	\$110.00	\$123.00	---	---	\$111.00
Talbot	\$119.00	\$119.00	---	\$131.00	
Wicomico	\$118.00	\$123.00	\$135.00	\$137.00	\$140.00
Worcester	\$110.00	\$123.00	\$100.00	\$104.00	\$111.00

Fair Rental Rate



- Remember those are averages
 - So rents can be higher and lower than that \$
- Available online for you at UME Grain Marketing page

Fair Rental Rate

- Can also find at aglaw.umd.edu
- USDA releases about August or September of each year

2014 MARYLAND AND DELAWARE COUNTY CASH RENTS

September 14, 2014 / Paul Goeringer



Photo by Edwin Rensberg



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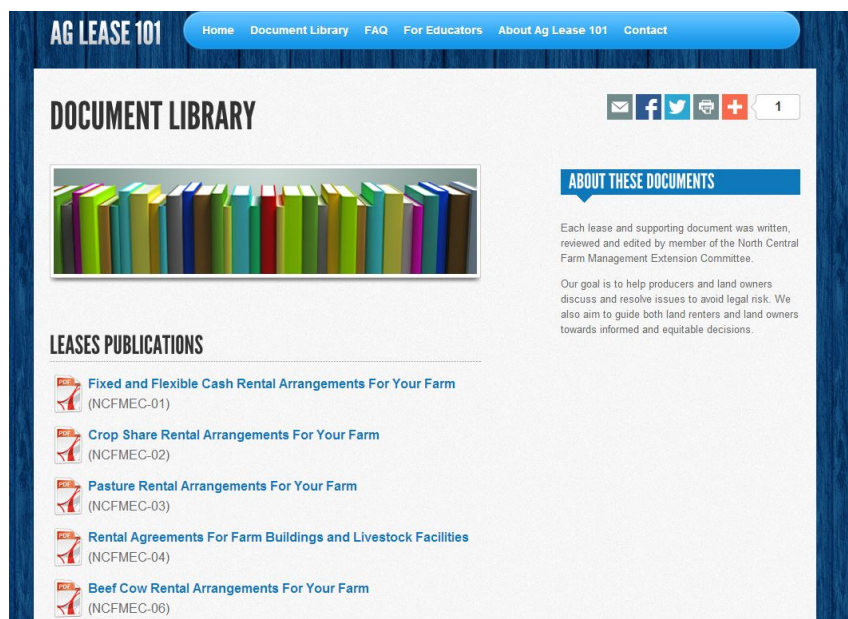
How to Calculate a Good Rent Price

- Many may have no idea where to start in calculating rent.
- Going to be a big deal to set a good rent:
 - Needs to be at level beginning farmer can afford
 - Needs to be at a level that is good for landlord
 - Potentially going to have to look at renegotiating this every year (not something we normally do in ag).



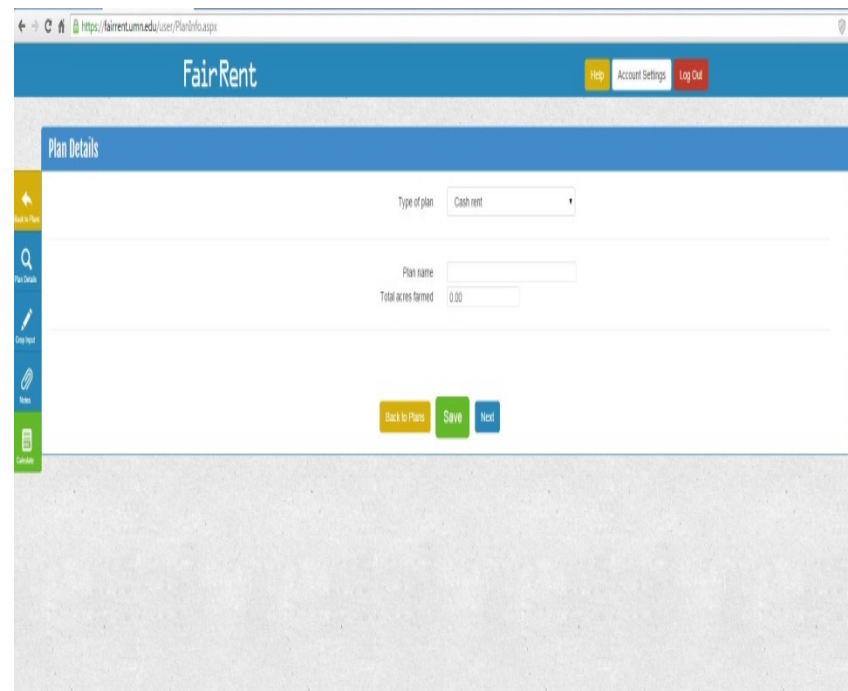
How to Calculate a Good Rent Price

- Aglease101.org has worksheets available to help calculate this rent level
- Has resources available to do cash, flex-cash, and crop-share rents



How to Calculate a Good Rent Price

- Don't like printing off a worksheet and using pen and paper?
- Fairrent.umn.edu is new online resource that lets user input in factors and it spits out rent levels.



The screenshot shows a web browser window with the URL <https://fairrent.umn.edu/user/PlanInfo.aspx>. The page has a blue header with the "FairRent" logo and links for "Help", "Account Settings", and "Log Out". Below the header is a "Plan Details" section. On the left side of this section is a vertical sidebar with icons for "Back to Plans", "Plan Details", "New Plan", "History", and "Calculate". The main content area contains a "Type of plan" dropdown menu set to "Cash rent", a "Plan name" text input field, and a "Total acres farmed" text input field with the value "0.00". At the bottom of the form are three buttons: "Back to Plans" (yellow), "Save" (green), and "Next" (blue).

How to Calculate a Good Rent Price

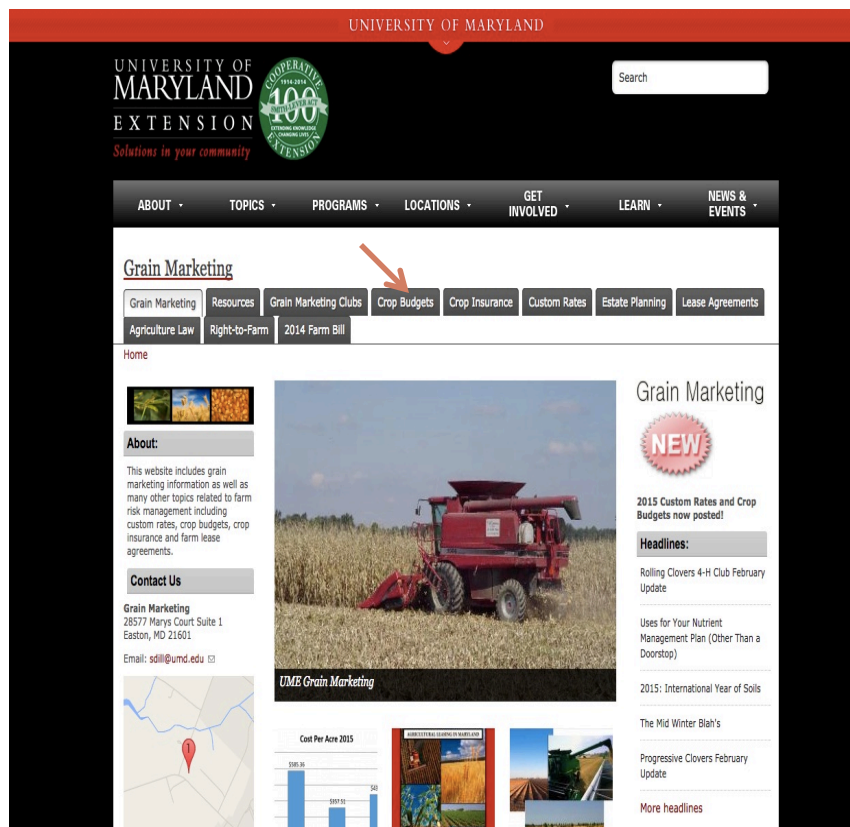
- Main drawback to both resources are you have to know your costs of production.
- If no idea what those are, budgets exist to give you an idea of some costs of production.

<http://extension.psu.edu/business/ag-alternatives/horticulture>



How to Calculate a Good Rent Price

- You will need to know costs of production
 - What does it take you to traditionally produce an acre of your crop?
 - What do you need to sale that crop at to make a profit?
- UME does have budget available for some crops
www.extension.umd.edu/grainmarketing



How to Calculate a Good Rent Price

- Can always talk to neighbors
- Good resource especially for beginning producers



SOURCES



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Example Farm

FairRent

Crop Input for Sample produce farm

Crop	Tomato	Watermelons	Sweet Corn
Unit	Acre	Acre	Acre
Acres	2	2	2
Expected yield	500.00	2,000.00	1,250.00
Expected price	\$10.00	\$3.00	\$3.00
Other income	0.00	0.00	0.00
Seed	539.95	900.00	51.40
Fertilizer	115.25	151.87	81.70
Chemicals	778.64	246.43	397.36
Crop insurance	0.00	0.00	0.00
Drying	0.00	0.00	0.00
Custom hire	115.87	249.80	135.85
Direct crop labor	1,003.44	1,357.70	280.50
Fuel	36.30	60.45	117.01
Repairs	8.92	33.38	84.18
Irrigation	650.00	787.80	217.80
Other direct expenses	1,483.54	1,344.90	921.80
Overhead expenses	50.00	50.00	50.00
Operating interest	42.87	62.67	27.62
Interest on rent	0.00	0.00	0.00
Operator labor & mgt	0.00	141.75	30.75
Crop insurance APH	0.00	0.00	0.00
Crop insurance price	0.00	0.00	0.00
Crop ins. coverage (%)	0.00	0.00	0.00

Add a Crop
Delete
Delete
Delete

Prev
Save
Next

Remaining for rent	663.25	1,404.03	225.22
Breakeven rent for all crops	764.17		
Maximum Rent to Cover Expenses			
	30 % Lower Revenue	15 % Lower Revenue	Expected Revenue
To cover direct expenses	-653	84	822
To cover direct and ovt'd expenses	-653	84	822
To cover unpaid labor & management	-711	27	764
			15 % Higher Revenue
			30 % Higher Revenue
			1,559
			2,297
			2,297
			2,239

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University of Minnesota

FairRent
www.fairrent.umn.edu

Sample produce farm

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11/5/2014

Cash Rental Analysis: Breakeven Cash Rent at Varying Yields and Prices

Watermelons

Price	1,400.00	1,700.00	2,000.00	2,300.00	2,600.00
Per Acre					
2.10	-2,397	-1,767	-1,137	-507	123
2.55	-1,767	-1,002	-237	528	1,293
3.00	-1,137	-237	663	1,563	2,463
3.45	-507	528	1,563	2,598	3,633
3.90	123	1,293	2,463	3,633	4,803

Sweet Corn

Price	875.00	1,062.50	1,250.00	1,437.50	1,625.00
Per Acre					
2.10	-508	-115	279	673	1,067
2.55	-115	363	842	1,320	1,798
3.00	279	842	1,404	1,967	2,529
3.45	673	1,320	1,967	2,613	3,260
3.90	1,067	1,798	2,529	3,260	3,992

Tomato

Price	350.00	425.00	500.00	575.00	650.00
Per Acre					
7.00	-2,325	-1,800	-1,275	-750	-225
8.50	-1,800	-1,162	-525	113	750
10.00	-1,275	-525	225	975	1,725



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Revisiting Rental Rates

- Big deal with cash rents
 - Many farmers still paying same rate they got 20 years ago on a farm – not just in Maryland all over the US.
 - Maybe in both parties interest to include language to recalculate the rental rate every 2 to 3 years.
 - That way cash rental rate isn't too low
 - As tenant could help prevent other farmers coming in and offering landlord more rent
- Same with flex-cash and crop-share rates, offer to revisit every 2 to 3 years just to make sure that:
 - Base rental rate (if you have one) accurately reflects any increases in cash rent value
 - Make sure all yield increasing expenses are covered (new tech. could come along not covered by original agreement).

THANKS

ANY QUESTIONS?

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